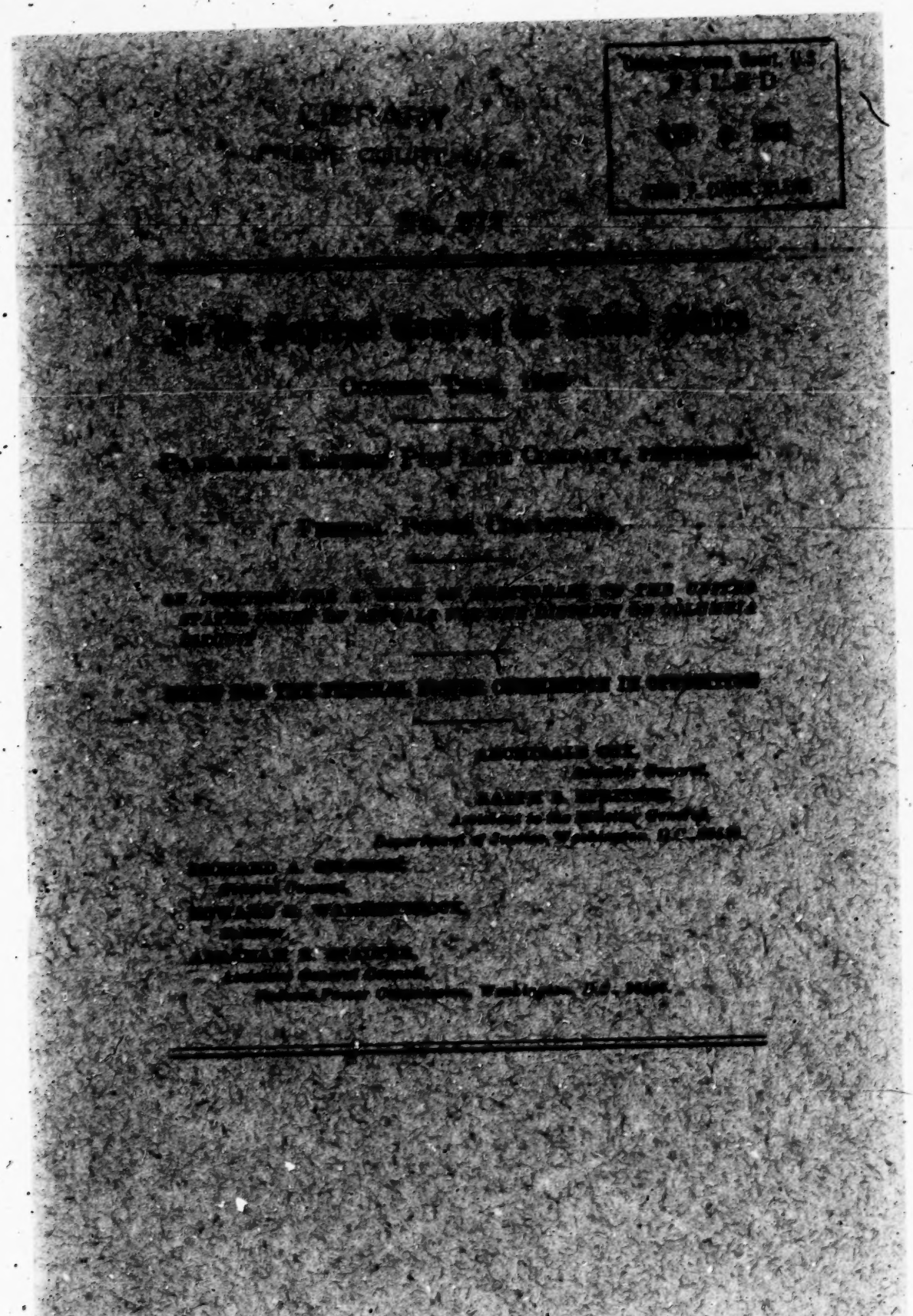


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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 277

PANHANDLE EASTERN PIPE LINE COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinions of the Court of Appeals for the District of Columbia Circuit (Pet. App. A, 16a–46a) are reported at 316 F. 2d 659. The opinion of the Federal Power Commission (Pet. App. B, 1b–6b) is reported at 25 F.P.C. 550. The Commission's opinion in *Northern Natural Gas Company* (Opinion No. 342, relevant portions reprinted, Appendix, *infra*, pp. 19–38) on which its present order was based, is reported at 25 F.P.C. 431, 433–441, 445–448.

JURISDICTION

The judgment of the court of appeals was entered on March 15, 1963. A timely petition for rehearing

en banc, filed by petitioner, was denied on April 18, 1963. The petition for a writ of certiorari was filed on July 16, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Was it error for the Federal Power Commission to allow a return of 1.5 percent on the portion of the rate base financed by funds representing the difference between the income taxes which Panhandle would have been required to pay without the use of liberalized depreciation and accelerated amortization, as permitted by Sections 167 and 168 of the Internal Revenue Code of 1954, and the taxes actually paid.

2. When a circuit judge advised the President of his intention to retire "to take effect only when [his successor] is ready to be sworn in," and thereafter, without any objection by the parties, sat as a member of the court *en banc*, was he disqualified to participate in the court's decision rendered more than a week before his successor's commission was signed by the President.

STATEMENT

The Federal Power Commission order under review establishes a rate of return of 6.25% on Panhandle Eastern Pipe Line Company's total rate base for purposes of determining just and reasonable rates under Section 4(e) of the Natural Gas Act (June 21, 1938, c. 556, 52 Stat. 821–833, as amended 15 U.S.C. 717–717w). Reflected in that rate of return is an allowance of 1.5% on $11,076,954 previously accumulated

out of revenues and maintained in a special reserve account entitled "Accumulated Deferred Taxes on Income" (Pet. App. 3b).[1]

This $11 million represents the accumulated difference between the "normalized" amounts of federal income taxes which the Commission allows as an operating expense in fixing Panhandle's rates (the amount Panhandle would have paid if it had computed those taxes on the basis of conventional, straight-line depreciation) and the lower amounts actually paid by the use of liberalized depreciation (as authorized by Section 167 of the Internal Revenue Code) and accelerated amortization (pursuant to Section 168 of the Code).[1a]

The methods of liberalized depreciation authorized under Section 167 have the effect of allowing larger depreciation expenses during the early years of life of a depreciable asset than in the later years. Thus, other factors remaining constant, during the early years of an asset's life liberalized depreciation results in lower federal income taxes than does straight-line depreciation, under which the depreciation expense is the same for each year of the asset's life. By the same token, during the later years of an asset's life liberalized depreciation results in lower depreciation

[1] While the Commission has not designated the balance sheet accounts technically as "reserves", in this brief, for convenience, we shall sometimes refer to them as reserves, since the technical distinction is not relevant to the present question.

[1a] $4,116,859 under Section 167; $6,960,095 under Section 168. Section 167 is a continuing provision, whereas Section 168 was a temporary measure, with no certifications permitted after 1959 (26 U.S.C. 168(f), as added by Act of August 26, 1957, 71 Stat. 415).

charges (and thus higher taxes) than does straight-line depreciation.[2]

Use of accelerated amortization has a similar but more pronounced effect. Under Section 168, to the extent that assets have been certified as emergency facilities, they may be fully depreciated for federal income tax purposes over a period of five years. This high rate of depreciation during the first five years makes for lower income taxes during that period. Thereafter, however, depreciation on the facilities in question having been "spent", taxes are higher than they would be on a straight-line depreciation basis.

Pursuant to established practices permitted by the Commission (*Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53, affirmed in relevant part, *sub nom. City of Detroit* v. *Federal Power Commission*, 97 App. D.C. 260, 230 F. 2d 810, certiorari denied, 352 U.S. 829; *El Paso Natural Gas Co.*, 22 F.P.C. 260, affirmed, in relevant part, 281 F. 2d 567 (C.A. 5), certiorari denied *sub nom. California* v. *Federal Power Commission*, 366 U.S. 912; *United Fuel Gas Co.*, 23 F.P.C. 512, affirmed *sub nom. Cities of Lexington* v. *Federal Power Commission*, 295 F. 2d 109 (C.A. 4)), Panhandle has been including within its operating expenses (for rate-making purposes) the amount of federal income taxes which it would have paid if it had computed such taxes on the basis of straight-

[2] This analysis applies to the effect of liberalized depreciation as to an individual asset. The company's overall depreciation allowance in any year will depend on the weighted average age of its depreciable assets, since below-straight-line depreciation on old-vintage assets will tend to be counterbalanced by above-straight-line depreciation on newly-acquired assets.

line depreciation. As prescribed by the Commission's accounting regulations (Orders Nos. 171, 171A and 203, 13 F.P.C. 968 and 1051, 19 F.P.C. 826, amending Uniform System of Accounts for Class A and Class B Natural Gas Companies, 18 CFR Part 201, Accounts Nos. 281, 282, 410, 411), the excess of this amount over the taxes actually paid has been placed in reserve accounts denominated "Accumulated Deferred Income Taxes".[3] Until such time, if ever, as they may be needed to pay income taxes higher than those computed on the basis of straight-line depreciation, the funds reflected in these accounts may not be paid out in the form of dividends[4] but constitute capital which the company can use in its operations.

Panhandle contends that the Commission erred in considering the source of these funds in determining a fair rate of return, which, it argues, should have been set at 6.46%, the weighted average cost[5] of its

[3] Account 281, balance sheet account for "Accumulated deferred income taxes—Accelerated amortization"; Account 282 (similarly for liberalized depreciation); the annual provisions for deferred taxes are classified in Account 410, "Provision for deferred income taxes"; Account 411, "Income taxes deferred in prior years—credit."

[4] In this brief, for convenience, we shall refer to this Commission—approved method of treating liberalized depreciation and accelerated amortization as "normalization." We shall use the term "flow-through" to refer to the alternative practice of including within federal income tax expense for rate-making purposes only the amount of such taxes actually paid with the use of these benefits. This terminology is in accord with general usage.

[5] The phrase "cost of capital" is here used as including, in addition to interest and preferred stock dividends, the return allowed on common equity although such return may not be "cost" under a literal definition of that word.

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capital secured from outside sources through bonds, preferred stock and equity securities.[6]

In including the deferred tax reserve in Panhandle's capital structure at 1½%, the Commission adopted the principles and policy which it had set forth in its Opinion No. 342, rendered on March 7, 1961, in *Northern Natural Gas Co.*, 25 F.P.C. 431, concerning liberalized depreciation, and which it had thereafter applied to accelerated amortization in *Kansas-Nebraska Natural Gas Co.*, Opinion No. 343, 25 F.P.C. 448. Since the rationale of the Commission's present order is set forth in Opinion No. 342, we are reprinting the relevant portion of that opinion as an appendix to this brief.

On September 27, 1962, a panel of the court of appeals (former Chief Judge Miller and Judge Burger, with Judge Bazelon dissenting) sustained Panhandle's

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[6] Before the Commission (R. 31) and the court below (No. 16,479, Pet. Br. 26), Panhandle contended, as an alternative, that its minimum permissible rate of return was 6.41% reflecting a return of 5.45% on the deferred tax credit. This 6.41% figure was devised to arrive at the same revenue before federal income taxes (*i.e.*, the same cost to ratepayers) as would result if the company were to raise equivalent funds by the sale of securities according to its existing ratio of bonds, preferred stock and common equity. The difference in net return to the company from these alternative methods of securing such capital results from the fact that interest costs on debt capital are deductible from taxable income for federal income tax purposes, and since there are no interest costs incident to the use of deferred tax reserves, taxes (which must be allowed ahead of return) are higher on income derived from such funds than they would be on capital which includes conventional interest-paying debt. At the corporate income tax rate of 52 percent, to realize $1 in net return, the company must receive $2.0833 in revenues.

Panhandle apparently has abandoned this alternative contention in its present petition.

contention. On the Commission's petition (Pet. 8), the case was re-argued before the court *en banc* (Pet. App. 47a) on December 15, 1962. On March 15, 1963, the panel's opinions were withdrawn (Pet. 8) and a majority of the court, in an opinion by Chief Judge Bazelon (in which Judges Edgerton, Fahy, Washington and Wright concurred), held that the Commission's decision was well within the range of its administrative discretion under the Natural Gas Act and was not prohibited by the Internal Revenue Code (Pet. App. 16a–22a). Judge Miller (joined by Judges Danaher, Bastian and Burger) dissented, on the grounds that the Commission's decision (1) failed to give the corporate taxpayer the benefits contemplated by Congress in enacting the revenue provisions in question, and (2) contravened prior rulings of the Commission sustained by the District of Columbia Circuit in relevant part in *City of Detroit* v. *Federal Power Commission, supra*, 97 App. D.C. 260, 230 F. 2d 810 (Pet. App. 22a–46a).

Panhandle thereupon petitioned for rehearing *en banc*, "suggesting" (Pet. 9) that Judge Edgerton should not have participated in the *en banc* proceeding and requesting that the decision "be vacated and rehearing *en banc* be granted in order to provide Judge Edgerton's successor an opportunity to participate in the decision." The petition also reargued the merits. On April 18, 1963, this petition was denied by unanimous vote of the Court *en banc* (Pet. App. 48a).

On March 22, 1962, Judge Edgerton had notified the President of his intention to retire from active duty, when his successor was "ready to be sworn in" (Pet.

9). On August 16, 1962, the President sent to the Senate his nomination of Mr. Carl McGowan as circuit judge "vice Henry W. Edgerton retiring." Cong. Rec. August 16, 1962, p. 15690 (daily ed.). The Eighty-seventh Congress adjourned without confirming the nomination. The nomination of Mr. McGowan "vice Henry W. Edgerton, retiring" was sent to the Eighty-eighth Congress on January 15, 1963. Cong. Rec. January 15, 1963, p. 359 (daily ed.). The Senate confirmed on March 15, 1963. Cong. Rec., March 15, 1963, p. 4150 (daily ed.). The President signed Judge McGowan's commission on March 27, 1963. On April 22, 1963, Judge McGowan took the oath of office.

ARGUMENT

The decision below approves, as well within agency discretion, a Federal Power Commission holding, in a rate case, that an overall rate of return on investment which includes a return of 14% on capital generated by the company's "normalization" of its income taxes is consistent both with the standards of the Natural Gas Act and the objectives of the tax statutes. This holding that the regulatory approach adopted was within the permissible range of choice is clearly correct and involves no conflict among the circuits. Nor, obviously, was the decision below invalidated by the participation in the *en banc* rehearing of a judge who had announced his retirement, effective when his successor was "ready to be sworn in", where the successor's appointment was confirmed the day the decision was announced but his commission was not signed by the President and he was not sworn in until later.

1. This case presents a narrow facet of a much mooted problem in fixing utility rates—how to treat income taxes which have been computed by using the rapid write-off of plant investment permitted by Sections 167 and 168 of the Internal Revenue Code. Section 167 permits larger deductions during the early years of the useful life[7] of each plant unit than would be available under the conventional "straight-line" method of depreciation accounting,[8] with resulting lesser percentages during later years. Section 168 permits deduction, in five equal annual installments, of investment in facilities certified as "emergency", thus writing off investment in those facilities much more rapidly than under "straight-line" accounting, with zero deductions during the remaining life of such facilities. Under both sections, with respect to a single unit of plant, there would result an increase of deductions (and hence a decrease in taxable income) during the early years followed by a decrease in deductions (and an inverse effect on taxes) during the later years of its useful life.

The first question, upon which there has been great divergence of policy among regulatory agencies, is whether rates fixed upon the basis of cost of service should cover only the taxes actually being paid, or whether allowance should be made for "normalized taxes", *i.e.*, taxes computed by the use of straight-line

[7] Under the straight line method the total investment in a plant unit is, in effect, charged off to operating expenses in *equal* annual installments over the anticipated life of the unit.

[8] The average life of depreciable plant of natural gas pipelines is in the neighborhood of 30 years.

accounting, with the excess (in the early years) of such normalized taxes over the tax amounts actually paid being accumulated in special "deferred tax" reserve accounts maintained for the purpose of absorbing any amounts by which the actual taxes in later years may exceed normalized taxes. Until needed for that purpose, such amounts, as part of the company's capital, are available to be invested in new plant or plant replacement, *i.e.*, "plowed in."

A further question arises where normalization has been followed long enough so that the amounts in the "deferred tax" accounts constitute a substantial part of the company's total capital available to be invested in used and useful plant. That question relates to the allowance of return on a corresponding part of the total investment in used and useful plant. Some regulatory bodies have required that it be subtracted from the rate base;[9] some have included it in the rate base, but with a zero return;[10] and still others have included such capital without assigning it any specified rate of return, thus making it impossible to be sure that they have not, in effect, allowed it a return

[9] *E.g., Public Service Company of New Hampshire* v. *State*, 102 N.H. 150, 153 A. 2d 801, 806; *City of Alton* v. *Commerce Commission*, 19 Ill. 2d 76, 165 N.E. 2d 513, 520-522; *Southern Indiana Gas & Electric Company*, 38 P.U.R. 3d 177, 180 (Ind.); *Cumberland & A. Gas Co.*, 36 P.U.R. 3d 321, 331 (Md.); *Wisconsin Fuel & Light Co.*, 12 P.U.R. 3d 254 (Wisc.).

[10] *E.g., Empire District Electric Co.*, 23 P.U.R. 3d 45, 49-53 (Kan.); *Ohio Fuel Gas Co.*, 25 P.U.R. 3d 207 (Ohio)—Ohio however subsequently switched to flow through, *Cincinnati Gas & Electric Co.* v. *Public Utilities Commission*, 173 Ohio St. 473, 184 N.E. 2d 84, 85; *Ohio Edison Co.* v. *Public Utilities Commission*, 173 Ohio St. 478, 184 N.E. 2d 76, 81.

equal to that allowed on the capital acquired by normal means of private financing.[11]

As the Fourth Circuit summed up the situation in *Cities of Lexington* v. *Federal Power Commission*, 295 F. 2d 109, 114 (C.A. 4):

> It is obvious that we are confronted in this case with a problem in a special field which requires the exercise of expert skill that has been generally entrusted by state and Federal legislation to administrative regulatory tribunals whose decisions, in the absence of abuse of discretion, should be followed by the courts. * * *.

The Federal Power Commission, with the approval of several courts of appeals,[12] has permitted but not required normalization.[13] And, in all cases where it has passed upon the matter, it has allowed a rate of return of 1½% with respect to capital generated by normalization. It is this latter determination which is challenged here.

A. Petitioner's principal argument in support of its position that the Commission is required to allow a "full return" on capital generated by normalization rests on its assertion that such a benefit to its stockholders is compelled by the legislative history of Sec-

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[11] *E.g.*: *Washington Water Power Co.*, 33 P.U.R. 3d 88, 94 (Idaho); *Washington Public Service Commission* v. *Washington Water Power Company*, 33 P.U.R. 3d 468, 474–475, 492 (Wash.).

[12] *Supra*, p. 4.

[13] The entire subject of normalization vs. flow-through, and the rate of return on capital generated by normalization, if normalization be continued, is currently under re-examination by the Commission. *Alabama-Tennessee Natural Gas Co.*, 28 F.P.C. 586. See the Commission's petition for rehearing *en banc* below, at 16–22.

tions 167 and 168. That history, like the language of the sections, admittedly makes no reference to the manner in which taxes computed thereunder by regulated companies should be treated for rate-fixing purposes. But, it is contended, the avowed purpose of the sections was to induce investment in new facilities, and the sections were made applicable to both regulated and unregulated industries alike. Since an unregulated business availing itself of either type of rapid tax write-off could, *if competition permitted it to do so*, use the savings to increase the dividend-producing assets of the company, this option, it is argued, should also be available to any regulated company choosing to utilize the write-off.

The short answer is that merely because a tax benefit is made available to both regulated and unregulated businesses alike does not mean that regulated businesses *pro tanto* cease to be subject to regulation. Thus, it would hardly be contended that if Congress reduced the general corporate tax rate, as the President has proposed, regulated companies could continue to have their rates set on the basis of taxes calculated at the previous higher rate merely because unregulated companies could, if economic conditions permitted, retain the difference between the taxes they would have been required to pay under the old rates and those due under the new.

In the case of the unregulated industries, tax benefits, like other cost reductions, need not be earmarked; the forces of competition determine whether savings will be passed on to the stockholders in dividends, set aside in a reserve, reinvested in new plant, or utilized to enhance the company's competitive position through

a reduction in prices. The underlying premise of the regulatory process, on the other hand, is that the interplay of competitive forces is inadequate to assure determinations consistent with the public interest. Accordingly, while a regulated company is entitled to charge rates sufficient to recover its cost of service, including a fair return on its invested capital, it has a concomitant obligation to operate with all reasonable economy, with such savings as are effected—whether as a result of action by management or of tax benefits provided by the government—serving to reduce the cost of service. See *El Paso Natural Gas Co.* v. *Federal Power Commission*, 281 F. 2d 567, 573, (C.A. 5), certiorari denied *sub nom. California* v. *Federal Power Commission*, 366 U.S. 912.[14]

It follows that a general Congressional purpose to make tax benefits available to both regulated and unregulated taxpayers cannot be converted into a mandate that the stockholders of a regulated company benefit at the expense of the rate payers. A *fortiori* it does not mean that the stockholders must receive the same return on capital generated (without cost to the company) as the indirect result of such tax benefits as they do with respect to capital raised through corporate financing. Significantly, the conclusion of

[14] In the *El Paso* case the court of appeals approved the Commission's action in permitting normalization by companies using liberalized depreciation on the assumption that the use of liberalized depreciation resulted in a tax deferral rather than a tax savings. The question of the return on capital generated thereby was not presented since the parties had stipulated to a 6 percent return for El Paso's transmission property and the Commission had fixed no rate of return on its well-mouth property, allowing it instead an amount equal to special tax savings (an action which the court set aside).

the court below, *i.e.*, that no Congressional purpose to benefit producers to the exclusion of consumers is reflected in the legislative history (Pet. 19a), is in complete accord with the views of the only other circuit to pass upon this matter. See *El Paso Natural Gas Co.* v. *Federal Power Commission*, *supra*, at 572 ("We think there is nothing in the legislative history that would warrant our concluding that Congress intended the * * * rapid depreciation provisions of the Revenue laws to amend or modify the express language of the Natural Gas Act * * *".) [15]

Nor can it successfully be contended that the Commission's determination failed to take account of the ultimate Congressional objective of stimulating investment in new plant. For the Commission not only pointed to the fact that there were a number of "material advantages" inherent in "the use of deferred taxes to supply a portion of the company's capital requirements" which would tend to induce additional investment [16] but, as further inducement, allowed peti-

[15] As the court below indicated, its language in a previous opinion in *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810 (C.A.D.C.), suggesting that Congress intended to benefit the regulated taxpayer rather than the consumer was made in the context of whether the Commission could properly include depreciation reserves in a company's rate base, and no issue was there involved as to the proper return on such funds. It is axiomatic that a decision of a court of appeals *en banc* resolving an alleged conflict of a decision by one panel with a prior decision of another panel of the court, provides no necessity for resolution of conflict by the Supreme Court.

[16] "* * * The substantial sums involved are readily available without resort to the market, and such additions to capital serve to reduce the company's debt ratio. The acquisition of plant by use of deferred taxes provides additional security not subject

tioner a 1½% return on the plant secured by use of funds generated by normalization, even though these funds were derived from the rate payers at no cost to petitioner. The court below properly held that these were substantial incentives to utilization of the tax write-offs for reinvestment purposes.[17]

B. Petitioner attempts to bolster its argument for a "full return" on deferred taxes by referring (1) to earlier Commission statements suggesting a Congressional purpose to provide benefits for the regulated company, rather than its customers, and (2) to the subsequent introduction of several bills which, according to petitioner, have amended the *Federal Power Act* to require the Commission to pass the benefits of liberalized depreciation directly to electric utility rate payers ("flow-through"). But the Commission's views as to the objectives of particular tax laws are surely subject to revision in the light of additional experience and understanding. Nor does the fact that Congress

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to lien on which new loans can be based, perhaps at lower interest rates than would otherwise be possible. Furthermore, deferred-tax funds accumulated between rate cases and invested in plant may, during that period, increase the company's earnings. Finally, the accumulation of deferred taxes increases the company's funds available for expansion without issuing additional common stock [fn. omitted]." Appendix, *infra*, p. 3).

[17] The possibility that petitioner may nevertheless refuse to utilize liberalized depreciation if it does not receive the return it demands, does not invalidate the Commission's determination, if it is otherwise reasonable. Certainly, in order to carry out the policy of the tax statutes, the Commission is not required to pay petitioner or any other company its asking price. As the court below stated (Pet. 21a), there is no indication that Congress bestowed any benefits upon regulated companies "beyond those necessary to provide incentives to investment * * *."

failed to enact new legislation indicate that it was necessarily ratifying the views of the Power Commission. See *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 348–349. It could just as well be argued that Congressional inaction constituted ratification of the diametrically opposed views as to the regulatory effect of the same two tax statutes simultaneously adopted by the Interstate Commerce Commission. *Amortization Accounting for Emergency Carrier Facilities*, 284 I.C.C. 9 (1951), affirmed, 299 I.C.C. 463 (1956); *Increased Freight Rates, 1956*, 298 I.C.C. 279, 289; *Accounting for Federal Income Taxes*, 24 Fed. Reg. 1401 (1959).

2. By the terms of his letter, Judge Edgerton's retirement from regular active duty was not to take effect until his successor was "ready to be sworn in." A federal judge has the right to retain his office so long as he chooses (Const., Art. III, Sec. 1), a right which may be ended only by impeachment or voluntary act of the judge himself. *Johnson* v. *United States*, 79 F. Supp. 208, 210 (Ct. Cl.). Thus, Judge Edgerton unquestionably remained qualified to participate in *en banc* consideration until Mr. Carl McGowan was "ready to be sworn in." Whatever the precise moment that condition was met, it certainly could not have been before March 27, 1963, when the President signed Judge McGowan's commission. Since the decision on rehearing was issued on March 16, 1963, the present case manifestly does not come within the scope of *United States* v. *American-Foreign SS. Corp.*, 363 U.S. 685, which held that Judge Medina should

not have participated in an *en banc* decision *after* his retirement had become effective.

Panhandle's position is that Judge Edgerton became ineligible the moment he indicated his intention not to remain as a "permanent" active member of the court (Pet. 20).[18] This contention that a judge becomes "inactive" and hence ineligible to sit on *en banc* matters when he announces his intention to retire in the future has neither good sense nor legal support. Judge Edgerton wisely exercised his right to retire from regular active duty in such a way as to prevent the unfortunate void which was presented in the *American Foreign Steamship* case, *supra*, p. 16.

His action conformed to the suggestion by Circuit Court Judge Kaufman in *United States* v. *Allocco*, 305 F. 2d 704, 712 (C.A. 2), certiorari denied, 371 U.S. 964, that such problems of judicial appointments "could be alleviated by suggesting to judges that they notify the President considerably in advance of antic-

[18] Panhandle raised no objection to Judge Edgerton's participation in the order granting rehearing *en banc* or to his sitting for the argument on December 15, 1962, long after Judge Edgerton's letter to the President and the President's nomination of Judge McGowan. Both these events had been widely publicized. Thus, to entertain Panhandle's present attempt to have Judge Edgerton disqualified would contravene what Mr. Justice Harlan has so aptly referred to as "an obviously sound policy of preventing litigants from abiding the outcome of a lawsuit and then overturning it if adverse upon a technicality of which they were previously aware." *Glidden Co.* v. *Zdanok*, 370 U.S. 530, 535. Cf., *Pacheco* v. *People of Puerto Rico*, 309 F. 2d 759, 760 (C.A. 1); *Fisher* v. *United States*, 170 F. 2d 273, 277, 278 (C.A.D.C.), certiorari dismissed, 338 U.S. 883; *In re United Shoe Machinery Corp.*, 276 F. 2d 77, 79 (C.A. 1).

ipated resignations or retirements." Petitioner's view would defeat the obvious advantages of such a smooth transition and deprive the court, for an indefinite period, of the service of one of its members in all cases calling for adjudication *en banc*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

RALPH S. SPRITZER,
Assistant to the Solicitor General.

RICHARD A. SOLOMON,
General Counsel,

HOWARD E. WAHRENBROCK,
Solicitor,

ABRAHAM R. SPALTER,
Assistant General Counsel,
Federal Power Commission.

SEPTEMBER 1963.

APPENDIX

Opinion No. 342

NORTHERN NATURAL GAS COMPANY, DOCKET NO. G–19040; PERMIAN BASIN PIPELINE COMPANY (NOW MERGED INTO NORTHERN), DOCKET NO. G–19041

OPINION AND ORDER DETERMINING RATE OF RETURN, DEFERRING DECISION ON ALLOCATION OF SYSTEM COSTS, DISALLOWING PROPOSED INCREASED RATES, DIRECTING PAYMENT OF REFUNDS, AND PERMITTING SUBSTITUTION OF LOWER INTERIM RATES

(Issued March 7, 1961)*

Commissioner Stueck *concurring.*

Chairman Kuykendall *dissenting in part.*

Before Commissioners: Jerome K. Kuykendall, Chairman; Frederick Stueck, Arthur Kline and Paul A. Sweeney.

This pipeline rate case is before us under the interim order procedure we have applied in recent cases providing for hearing and decision of particular issues susceptible of being decided prior to the completion of the entire hearing. It arose on the filing on June 26, 1959, by Northern Natural Gas Company (Northern) and its then wholly-owned subsidiary, Permian Basin Pipeline Company (Permian), of proposed increased rates under Section 4(d) of the Natural Gas Act (Act).

Return on deferred income tax accruals. The question of the proper treatment, in fixing rates of return,

*Designated Commission Opinion No. 342. Rehearing denied by order issued April 20, 1961.

of amounts accumulated in a deferred tax account by reason of a company's election to use liberalized depreciation, as provided in Section 167 of the Internal Revenue Code, has not yet been determined by us. The increasing importance of this question is indicated by the extent of these tax accruals. In Northern's case, as shown above, they amount to in excess of eight million dollars. Based on reports by the companies to the Commission, it appears that the amount of such accruals in the year 1959 by natural-gas pipeline companies subject to Commission jurisdiction aggregates some $39,000,000; and total accruals by such companies to date approach $110,000,000. The question of how to treat these accruals is now directly before us in the present Northern proceeding and a determination must now be made that will affect other proceedings before us and those that will arise in the future.

Our previous determinations with respect to the treatment of liberalized depreciation have not dealt with the computation of rate of return but rather the question of the normalization of taxes. That is, whether a natural-gas company should be permitted to compute its income taxes for rate-making purposes on the basis of normal straight-line depreciation while using the liberalized depreciation method permitted by Section 167 in its tax returns. As compared with straight-line depreciation, the liberalized method provides higher depreciation deductions, resulting in lower taxes, during the early part of the life of a given property, while lower deductions and higher taxes result in the later years of the life of the property. The total depreciation deductions available to a company over the entire life of a facility and the total tax results of such deductions are the same using either method or a combination of the two. The comparative advan-

tage provided by the statute allowing liberalized depreciation is that it defers to the later life of a given property a portion of the taxes on income that would be payable in the early years under straight-line depreciation, and gives the company the use of such moneys in the interval.

In the *Amere* case,[5] the company and others filed a petition requesting us to issue a declaratory order to remove uncertainty relating to the treatment of liberalized depreciation. We affirmed our presiding examiner who concluded that the tax allowance to be included in the company's cost of service should be normalized to conform to the straight-line depreciation methods normally used under our Uniform System of Accounts, but that any portion of the tax allowance not actually paid in a given year, that is, the deferred taxes, should be reserved in a special account to cover the amounts by which future taxes would be greater than the normalized taxes reflected in rates. This treatment of liberalized depreciation distributes the tax and rate effects of depreciation expense equitably over the productive life of a facility and implements the Congressional intent to allow regulated industries, like other industries, thus to provide all or at least a portion of the additional capital needed for desired expansion.

Order No. 203, 19 FPC 826, put these conclusions into effect by amending the Uniform System of Accounts to include a new Account 266,[6] Accumulated Deferred Taxes on Income, to be credited with amounts by which income taxes paid were lower than normal because of the use of liberalized depreciation and correspondingly debited when taxes become higher

[5] *Amere Gas Utilities Co., et al.*, 15 FPC 781.

[6] Redesignated Account 281, effective January 1, 1961.

than normal.[1] We have thus allowed companies such as Northern to accumulate substantial sums in these deferred tax accounts and to invest these amounts in company facilities. The further question now presented is what return, if any, should the gas industry subject to our jurisdiction be allowed to earn on the portion of its capital investment so accumulated.

The position taken by the staff in this and other proceedings is that the accumulated deferred tax funds should be included as a part of the capital structure of the company at a zero rate of return. Staff argues that it would be erroneous to exclude Northern's accumulated deferred taxes from a factual statement of company capital, even though it does not constitute actual debt liability, since these funds, which were supplied by the consumer, are available for any corporate purpose except dividend payments, including investment in facilities on which the company would expect to be allowed a rate of return. Accordingly, staff contends that this amount may appropriately be included as debt in determining the relative proportions of debt and equity. Furthermore, it contends that such amount should be included at zero cost since the consumer provides these funds through the payment of rates at no cost to the company. Under staff's approach, the percentage of debt capitalization would be increased to 55.34 percent and the over-all cost of debt would be reduced from 4.01 percent to 3.88 percent. This would leave the same return of 2.15 percent on debt including deferred taxes and would reduce the over-all return to 6.22 percent.

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[1] This same treatment is accorded deferred taxes accumulated using accelerated amortization for tax purposes, as permitted by Section 168 of the Internal Revenue Code. Order No. 174, 13 FPC 968, April 21, 1954; *Panhandle Eastern Pipeline Co.*, 13 FPC 53, Opinion No. 269, April 15, 1954.

Northern, on the other hand, takes the position that it should be permitted to invest the tax accruals in facilities, which would become a part of its rate base, without including such investment as a part of its capital structure and without requiring any reduction in the rate of return to take account of the earnings from such facilities.

Northern argues that the funds represented by tax reserves are not contributed by nor do they belong to the customer, who under prescribed accounting procedures pays the same amount for income taxes whether or not the company takes advantage of the liberalized depreciation provisions of the Internal Revenue Code. If the company owns the funds, says Northern, the company's profitable use of such funds intended by Congress, including even their possible investment in non-regulated business, should not be precluded by regulatory action. Northern suggests that without the prospect of earning a return on the funds so provided, there would be little reason for the utility management to elect a rapid depreciation. It further suggests that allowing such funds to earn a return might improve a natural-gas company's financial standing and reduce its costs of financing, thereby benefitting its customers. Northern would thus use a capitalization excluding the deferred tax item composed of debt 54.5 percent, preferred stock 13.5 percent, and common equity 32 percent. Applying a 10.5 percent rate of return on equity to this capital structure would result in a return to Northern of 6.34 percent computed as follows:

	Ratio	Cost	Return
	Percent	*Percent*	*Percent*
Debt	54.5	4.01	2.19
Preferred stock	13.5	5.88	.79
Common equity	32.0	10.5	3.36
Over-all return			6.34

The use of liberalized depreciation by companies subject to Federal or state regulation has been the source of much litigation. Many jurisdictions have taken the view that a regulated company may not include in its cost of service any larger amount for taxes than the amounts actually paid by it. The effect of this method, commonly referred to as the flow-through method, is to pass on to the ratepayers immediately all savings accruing as a result of the use of liberalized depreciation. Other jurisdictions have taken the view that normalization of taxes should be permitted. As stated above, we took this view in our decision in the *Amere* case, *supra*, and adhered to it in our opinion in the *El Paso*[8] and *United Fuel*[9] cases. See also *Panhandle Eastern Pipe Line Company*, 13 FPC 53, Opinion No. 269, dealing with the treatment of accelerated amortization under the provisions of Section 168 of the Internal Revenue Code.

In those jurisdictions which have taken the view that normalization of taxes should be permitted there has been a divergence of views as to how the accumulated tax funds should be treated. Some have been of the view that the amount of accumulated deferred taxes should be deducted from the rate base.[10] Others, including this Commission in the *Panhandle* case, *supra*, have been of a contrary view. Some jurisdictions have adopted the view, urged by our staff, that the accumulated deferred taxes be included as a part of the capital structure at a zero percent rate of re-

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[8] *El Paso Natural Gas Company*, 22 FPC 260.

[9] *United Fuel Gas Company*, 23 FPC 127.

[10] See, for example, *City of Alton* v. *Commerce Commission*, 19 Ill. (2d) 76, 165 N.E. (2d) 513, 522. (This is also the position of the Civil Aeronautics Board.)

turn.[11] In New York, the Public Service Commission has held that the benefits of liberalized depreciation should be divided between the ratepayers and the company and has permitted the company to earn a small rate of return on the moneys accumulated from deferred taxes.[12]

Although we have not previously been confronted with this precise question, some aspects of it have been raised in two cases decided by us which have been subsequently appealed to the courts. In both of these cases, the court affirmed our view that normalization of taxes should be permitted. In the *City of Detroit case*,[13] an appeal of the *Panhandle Eastern Pipe Line Company* decision, *supra*, the Court in discussing the question of whether the accumulated deferred taxes should be deducted from the rate base said:

> Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of the deferred taxes to accrue after the five-year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit sub-

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[11] See, *Re Empire District Electric Company*, 23 PUR 3d, 45 (Kansas); *Re Michigan Gas & Electric Company*, 24 PUR 3d, 278 (Michigan); *Re Ohio Fuel Gas Company*, 25 PUR 3d, 207 (Ohio); *Re Pacific Power & Light Company*, 34 PUR 3d, 36 (Oregon).

[12] In *Re Central Hudson Gas & Electric Corporation*, 28 PUR 3d, 317, 329 (1959).

[13] *City of Detroit* v. *F.P.C.*, 230 F. 2d 810 (CADC 1955).

> stantially from Section 124A. This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms the petitioners. We think this is the result sought by Congress.

In the *El Paso* case,[28] an appeal of the *El Paso* decision, *supra*, the court in discussing our treatment of liberalized depreciation said:

> * * * It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequences of rate regulation. * * *
>
> * * * Therefore, we approve the Commission's treatment of the "saving" resulting from using the declining balance method of depreciation for tax purposes but computing its taxes for rate making purposes on the straight line method of depreciation, placing such "savings" in a special reserve to be used to equalize tax payments in later years. These amounts can never represent added return to the company because of the restriction as to their use. * * *

Although the question of what consideration should be accorded the amounts in the deferred tax accounts was not directly before either of these courts, it would seem that, as urged by Northern, the *City of Detroit*

[28] *El Paso Natural Gas Company* v. *F.P.C.*, 283 F. 2d 567 (CA 5, 1960).

case supports its point of view, while the *El Paso* case would seem to support the staff's view.

It is true that the *City of Detroit* case dealt with accelerated amortization only and the *El Paso* case with liberalized depreciation, and different statutes having a different legislative background are involved. We believe it wiser not to attempt to distinguish between these two statutes but to adopt the same view as to all tax accruals, whether obtained from use of Section 167, dealing with liberalized depreciation, or Section 168, dealing with accelerated amortization.

The *Panhandle* (City of Detroit) case was considered by us shortly after the enactment of Section 168. At that time, neither we nor the courts were fully aware of all of the consequences which would result if moneys in the deferred tax accounts were considered as belonging solely to the company. Thus, the statement in the above quotation from the *City of Detroit* case that to permit the company to use the funds for income-producing purposes would not result in higher rates to the consumer has on more careful consideration been disclosed to be erroneous.

If we were to adopt the view urged on us by Northern and the apparent view of the court in the *City of Detroit* case that moneys in the deferred tax account were the company's money and that it was entitled to all income produced from such moneys, it would be necessary to include in the cost of service an additional sum of 108.33 percent (the ratio which the 52 percent corporate income tax rate bears to the amount of 48 percent retained by the taxpayer) of the amount earned on such moneys for the payment of Federal income taxes. To illustrate this point, in the present case if the $8,375,740 in Northern's deferred tax account is neither deducted from the rate base nor included in the capital structure at less than the 6¼

percent rate of return prescribed for Northern, Northern will presumably earn on this money at the allowed rate of 6¼ percent a sum of approximately $523,500.00. However, this will increase its actual Federal income taxes by $567,125.00. Since Northern is entitled to include its actual taxes in its cost of service, the ratepayer would be required to pay this additional sum and would be penalized in this amount by reason of the fact that Northern took advantage of liberalized depreciation.

In the case of those companies operating in states having corporate income taxes, an additional amount would have to be included in the cost of service as an allowance for state income taxes.

Furthermore, our staff argues that if Northern, instead of obtaining these sums through use of the liberalized depreciation, had borrowed this amount on the market at the prevailing rate, the entire amount of interest would have been deductible for tax computation purposes and the amount of taxes included in the cost of service reduced. Thus, assuming that Northern had borrowed this money at 5 percent, its interest cost of $418,800 (5 percent of $8,376,740) would have been a further deduction in the computation of its income taxes, resulting in a lowering of the amount of Federal income taxes to be included in its cost of service by $218,780 (52 percent of $418,000). Although we consider it unrealistic to assume that a company would borrow as senior debt all of the moneys needed by it, and that it would be more fair to consider that additional moneys would be obtained without substantial change in the existing ratio between debt and equity, it is entirely possible that in some instances all of the money would be borrowed. In such cases, the use of liberalized depreciation would require higher rates to be paid

by the ratepayer unless the rate of return allowed on the deferred tax moneys was fixed so that the combined return and associated taxes would be less than the return in the event the moneys were raised through the issuance of bonds or other debt securities.

Since use of liberalized depreciation without either deducting the accrued tax deferrals from the rate base, or taking them into consideration in fixing a rate of return requires the ratepayer to pay more than he would be required to pay if liberalized depreciation were not used, we must reject the company's position.

While we thus believe it is unnecessary to reject Northern's contention we must for equally sound reasons reject the contention of our staff that the accrued deferred taxes should be included in the capital structure at zero percent interest. The treatment suggested by staff would deprive the company of any earnings from the accumulated deferred taxes and would have the same practical effect as though the amount of deferred taxes were excluded from the rate base. This would deprive the company of most of the benefits arising from use of liberalized depreciation. Northern and other companies appearing before us have stated that if this is done that no valid reason exists for continuing to take advantage of the liberalized depreciation statute and that they may return to straight-line depreciation in the computation of their Federal income tax liability. Experience has shown that this is not an idle threat. Many, probably a majority of the companies regulated by commissions which have required that the benefits accruing as a result of the use of liberalized depreciation be passed on to the ratepayer, either by adoption of the flow-through method, or by requiring that the accrued deferred taxes be deducted from the rate base,

have ceased to take advantage of Section 167 of the Internal Revenue Act and have returned to straight-line depreciation in the computation of their income taxes.[6]

It is obvious that Section 167 affords definite advantages over the use of straight-line depreciation in that it lowers the amount of taxes currently payable. The use of the moneys not currently paid to the Treasury as taxes is a definite material advantage to the person having the use of such moneys. To adopt a policy which would give all of this advantage to the ratepayer and none to the company, and which, as experience has shown, will very probably result in the failure of the company to use liberalized depreciation, would be extremely shortsighted on our part.

In our view, the best solution to this problem is to divide the benefits of liberalized depreciation between the regulated company and the ratepayer. In dividing these benefits between the ratepayer and the company, we are guided by the principles that it is our duty to protect the consumer and adopt rate-making principles which will assure the lowest possible rates. Accordingly, we believe that the major portion of the benefits accruing from the use of liberalized depreciation should go to the ratepayer, and the company should be allowed only so much of the benefits accruing from the use of liberalized depreciation as is necessary to provide it with a sufficient incentive

[6] Many electric companies over which both this Commission and state commissions have accounting or rate jurisdiction, whose principal operations are in a state that has required flow-through or deduction from the rate base for rate-making purposes have notified this Commission that they are no longer taking advantage of liberalized depreciation under Section 167. We are advised that a majority of the regulated companies in such states have ceased to use liberalized depreciation.

to continue to use liberalized depreciation, and not return to the use of straight-line depreciation in the computation of its income taxes. How much of a return should be allowed on the moneys in the deferred tax account to assure their continued use, is largely a matter of judgment based upon such factors as our knowledge of the money market, and our estimate as to what course most regulated companies will elect to pursue in the future. After careful consideration of all of the various factors involved; we are of the opinion that a return of 1.5 percent on moneys in the deferred tax account is a sufficient incentive to a regulated company to induce it to take advantage of the provisions of Section 167. We are further of the opinion that any figure appreciably lower than this will probably cause the company to return to the use of straight-line depreciation with its corresponding loss of benefits to the ratepayer.

Assuming a 10.5 percent return on equity, the allowance of a 1.5 percent return on the deferred tax account moneys results in a return of 6.25 percent to Northern as compared with a return of 6.34 percent if we allowed the company the same return on the tax moneys as it earns over-all, or a return of 6.22 percent if the staff view of a zero percent return on the deferred tax moneys were adopted.

Although our decision to allow a return of 1.5 percent is largely a matter of judgment as to what return we believe necessary to serve as an incentive to induce Northern to continue to use liberalized depreciation, it is supported by various computations. If, having allowed Northern a return of 6.25 percent, it should decide to go into the market to borrow money instead of raising it by use of the liberalized depreciation provisions of the income tax law, it

would probably have to pay in the neighborhood of 4.5 percent to 5.0 percent for its senior debt money under present market conditions. This would result in a net return to existing stockholders of 1.25 percent to 1.75 percent[a] on the borrowed money. To allow less than 1.5 percent return on the deferred taxes would mean that it might be more profitable for Northern's stockholders to enter the money market and borrow this money rather than take advantage of the provisions of Section 167.

We have stated earlier that it is probably neither fair nor realistic to assume that Northern will borrow all of this money. Accordingly, we have considered what would happen assuming that Northern raised its money in any one of several different ways. For purposes of illustration we have shown on the attached table the return to the company and the cost to the ratepayer of raising capital from average industry sources.[b] From this example it is apparent that the cost to the ratepayer if Northern would use straight-line depreciation and raise its capital through ordinary industry sources would be $716,000 more per year than if it used liberalized depreciation, while the increased benefit to the company stockholders would be only $150,000. (This increased benefit would, of course, go to more stockholders since the example assumes the raising of additional equity). Consideration of this and other similar examples lends support to our conclusion that a figure of 1.5 percent provides a reasonable, but not excessive, incentive to Northern.

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[a] This is a rough computation only, and the actual net return to the stockholders might be slightly higher.

[b] This illustration of 60 percent debt, 10 percent preferred stock and 30 percent common equity is very close to the average capital structure of major pipeline companies.

Apart from earnings, the use of deferred taxes to supply a portion of the company's capital requirements has certain material advantages. The substantial sums involved are readily available without resort to the market, and such additions to capital serve to reduce the company's debt ratio. The acquisition of plant by use of deferred taxes provides additional security not subject to lien on which new loans can be based, perhaps at lower interest rates than would otherwise be possible.[*] Furthermore, deferred tax funds accumulated between rate cases and invested in plant may, during that period, increase the company's earnings. Finally, the accumulation of deferred taxes increases the company's funds available for expansion without issuing additional common stock. It thus gives the existing stockholders the entire benefit of any earnings from the new investment. Our conclusions, giving due consideration to all the factors involved, is that these advantages, taken with a net return of one and one-half percent, constitute a reasonable and sufficient incentive to the pipeline industry to use liberalized depreciation for tax purposes and secure for its customers the substantial savings made possible by the statute. This mutually beneficial result gives such effect to the purposes of the tax statute as is appropriate within the principles of regulatory law expressed in the Natural Gas Act.

Commissioner Stueck *concurring*, filed a separate statement.

Chairman Kuykendall *dissenting in part*, filed a separate statement.

[*] To the extent that lower interest rates result, this will also benefit the consumer.

STUECK, Commissioner, *concurring:*

I concur in the action taken by the majority of the Commission in this case to permit an order to be forthcoming. However, I do so reluctantly since I am not fully convinced that the one and one-half percent rate of return allowed on funds realized by deferment of taxes provides a sufficient incentive to carry out the intent of Congress to stimulate business activity.

KUYKENDALL, Chairman, *dissenting* in part:

I dissent from the conclusion that

> In our view, the best solution to this problem is to divide the benefits of liberalized depreciation between the regulated company and the ratepayer. In dividing these benefits between the ratepayer and the company, we are guided by the principle that it is our duty to protect the consumer, and adopt ratemaking principles which will assure the lowest possible rates. Accordingly, we believe that the major portion of the benefits accruing from the use of liberalized depreciation should go to the ratepayer, and the company should be allowed only so much of the benefits accruing from the use of liberalized depreciation as is necessary to provide it with a sufficient incentive to continue to use liberalized depreciation, and not return to the use of straight line depreciation in the computation of its income taxes.

It is our duty to apply the law (that is section 167 of the Internal Revenue Code), and not our discretion, to the facts before us. We have only the legislative powers which Congress has given us, and have no power to amend section 167, distributing as we see fit the advantages given to the taxpayer by this statute.

We should, as the language of the Court of Appeals in the *City of Detroit* case, *supra*, quoted by the majority, clearly states, allow the taxpayer the full advantage of the tax deferral, but without any disad-

vantage to the ratepayer. The fact that the court did not mention, and may not, in fact, have considered the possible tax deduction arising by virtue of payment of interest on borrowed money does not alter the principle involved.

My colleagues seem to assume that the amounts accumulated through the deferral of taxes would otherwise be obtained through borrowing, or that, in any event such sums should be treated as the equivalent of debt capital. In my opinion, this is error. Such funds actually are as much or more akin to equity than to debt capital. We recognized this fact in our Order No. 203 amending our uniform system of accounts, 19 FPC 826, when we considered the possibility of setting up the reserve account as earmarked surplus. Our prohibition against payment of dividends from these funds would seem to presuppose that such sums are included in surplus.

The fairest and most logical assumption is that these amounts would have been obtained from the various sources in the same proportion as all of Northern's other capital has been obtained. On this premise, a rate of return of 3.27075% on the capital accumulated from deferred tax accruals will yield Northern the same income it would get if such capital had been obtained through conventional financing and not only will not harm the ratepayer, but will actually benefit him substantially. This is shown by the attached schedule.

Note that by use of conventional financing, it would cost the ratepayers $891,261 to supply Northern with a rate of return of 6¼% on an amount equal to the accumulated deferred income taxes, of which $273,982 would be the net return to Northern. On the other hand, a return of 3.27075% on the capital from deferred tax accruals would yield the same net return to Northern at a cost of only $569,882 to the rate-

payers. Thus the ratepayers would save $321,379, or 36% of the cost of conventional financing, and Northern would receive 100% of what it would receive if conventional financing were used.

The majority quote the following languages from the *El Paso* case, *supra*:

> It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings, as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequence of rate regulation.

This language was used by the court in discussing and disposing of tax savings (percentage depletion and intangible well drilling costs) and does not pertain to tax deferrals, and consequently has no relevance in the majority's opinion.

The following sentence in the *El Paso* opinion, *supra*,

> These amounts can never represent added return to the company because of the restriction as to their use,

does not, I believe, mean that the company cannot invest and earn on the sums accumulated for deferred taxes. It is undisputed that Sec. 167 was enacted specifically for that purpose. In the *El Paso* case, the problem presented to the court was whether liberalized depreciation constituted a tax saving or a tax deferral. There was no issue, such as we have here, as to the effect of a lack of interest payments to be used as a tax deduction, which deduction would be present if conventional financing were used.

What do the words "restriction as to their use" mean? The only restriction I know of is the restriction we have placed against using these funds for the

payment of dividends, and that must be the restriction to which the court was referring. In my opinion, the court used the word "return" as a synonym for "dividends."

The views I have expressed herein are, I believe, consistent with section 167 and its legislative history, with the only two court decisions which are controlling (*City of Detroit* and *El Paso, supra*), and are fair to the rate payer; yet they do not constitute a usurpation of the constitutional power of Congress.

NORTHERN NATURAL GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED CAPITALIZATION—DECEMBER 31, 1959

Total capitalization

		Ratio	Cost*	Return at 6¼%
		Percent	*Percent*	*Percent*
Debt	$243,311,000	54.5	4.01	2.18545
Preferred Stock	60,412,500	13.5	5.88	0.79380
Common Equity	142,650,748	32.0	10.22	3.27075
	$446,374,248	100.0		6.25000

Deferred Federal Income Taxes were $8,376,740 at Dec. 31, 1959

Deferred taxes

			Return	Tax allowance at 108% of taxable income	Annual cost to ratepayers	Tax paid	Interest paid	Preferred dividends paid	Net return to common equity
$8,376,740 capital from normal industry sources:									
Debt	$4,565,329	54.5%							
Preferred Stock	1,130,860	13.5							
Common Equity	2,680,557	32.0							
	$8,376,740	100.0%							
6¼% return			$523,546	$807,715	$891,261	$807,715	$183,069	$66,495	$273,982
2 $8,376,740 capital from deferred tax accruals: 6¼% return			523,546	555,430	1,088,976	555,430			523,546
3 $8,376,740 capital from deferred tax accruals: 3.27075% return			273,982	295,900	509,882	295,900			273,982

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